

TEACHERS' RETIREMENT BOARD
SUBCOMMITTEE ON CORPORATE GOVERNANCE

SUBJECT: Investment Protection Principles – Update

ITEM NUMBER: 4

ATTACHMENT(S): 2

ACTION: _____

DATE OF MEETING: November 6, 2002

INFORMATION: X

PRESENTER(S): Janice Hester Amey

Executive Summary

The External Equities/Corporate Governance asset class sent out letters, along with copies of the Investment Protection Principles and the Questionnaire to all of its investment manager and directed brokerage relationships. The other asset classes are expected to complete their mailings by November 1, 2002. Below is a recap of our activity:

- 30 Letters, Principles, Questionnaire (Packages) sent to Domestic and International Managers on 10/9/02;
- 24 Packages sent to Domestic and International Directed Brokerage Participants on 10/9/02;
- Questionnaire should be completed and returned by 10/31/02;
- Questionnaire should be signed by a senior officer with authority to sign on behalf of the firm;
- All relationships have been informed that this (questionnaire) will be an annual requirement for CalSTRS, going forward;
- All relationships have been informed that CalSTRS expects them to adopt and implement the Principles by December 15, 2002;
- Over the next few months, ending February 28th, staff will continue to work with contact relationships to resolve any compliance issues;
- An update will be provided to the Subcommittee at the March meeting;

A sample package that was sent to our investment managers and directed brokers is also included as Attachment 1. Attachment 2 is a graphic timeline of the Investment Branch's Implementation Plan.



October 17, 2002

«FirstName»
«Company»
«Address1»
«CityStateZip»

Dear «FirstName»:

As you may be aware, the New York State Comptroller, the North Carolina Treasurer and the California State Treasurer recently announced their support for the Conflict of Interest/Investment Protection Principles (Principles). These principles were derived from the settlement agreement between Merrill Lynch and the New York Attorney General. The trustees expect that firms that do or seek to do business with their states will adhere to the highest standards of integrity and disclosure. This is part of a larger effort by many public pension funds to address the lack of accountability that is evident in our financial institutions and markets.

At the July 10, 2002 meeting of the CalSTRS Subcommittee on Corporate Governance, the Principles were adopted. As «Company» participates in the CalSTRS Directed Brokerage Program, you are being sent a copy of a questionnaire, as well as a copy of the Principles that CalSTRS expects you to subscribe to/endorse.

If you have any concerns with the subject of this letter, please contact me at (916) 229-3723 or Elleen Okada at (916) 229-3721 immediately. We are requesting that you complete and return the enclosed questionnaire to us by **October 31, 2002**. A senior officer of your firm with authority to sign on behalf of the firm must sign the questionnaire. This will be an annual requirement for all of CalSTRS Directed Brokerage participants, going forward. CalSTRS is looking to have all its brokers adopt and implement the Principles by **December 15, 2002**.

Thank you in advance for your expeditious response to this directive.

Sincerely,

Christopher J. Ailman
Chief Investment Officer

Enclosures

California State Teachers' Retirement System
Questionnaire Regarding Investment Protection Principles

Name of Firm: _____

“Financial organization” for purposes of this Questionnaire means: “any financial organization that is authorized to provide investment banking services and/or broker/dealer services to the California State Teachers' Retirement System (CalSTRS) and that also provides equity research and investment banking services to any client.” According to this definition, your firm is a financial organization that does business with CalSTRS.

1. Has the firm duly adopted (e.g., by governing board approval or action of authorized executives) and implemented Part “A” of the Principles?”

Yes _____

No _____

If the answer to question 1 is “yes”, complete the signature block at the end of the Questionnaire and return it and a copy of the policy to the address indicated on page 2.

2. If the answer to question 1 is “no”, does this firm commit to adopt and implement such a policy by December 15, 2002*?

Yes _____

No _____

If the answer to question 2 is “yes”, complete the signature block at the end of the Questionnaire and return it to the address indicated on page 2. Also send a copy of the policy as soon as it is available, but no later than December 15, 2002.

3. If the answer to question 3 is “no” because this firm cannot implement such a policy by December 15, please fill in a date this firm can commit to implementing such a policy.

Date _____

*For the purpose of this Questionnaire, implementation of these Principles may include implementation of a plan that, while not identical, meets or exceeds the substantive requirements set out in Part “A” of the Principles.

California State Teachers' Retirement System
Questionnaire Regarding Investment Protection Principles ("Principles")

A senior officer of the firm with requisite authority to sign on behalf of the firm must sign the questionnaire. Please return the completed questionnaire to the address indicated below by October 31, 2002.

Information completed and certified by:

Name

Title

Firm

Signature

Date

Please return to:

Ms. Elleen Okada
Director Investments Administration & External Relations
7667 Folsom Blvd., Ste. 250
Sacramento, CA 95826

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

STATE AND PUBLIC PENSION FUND INVESTMENT PROTECTION PRINCIPLES

A. Every financial organization that provides investment banking services and is retained or utilized by the California State Teachers' Retirement System (CalSTRS) should adopt the terms of the agreement between Merrill Lynch & Co., Inc. and New York State Attorney General Eliot Spitzer dated May 21, 2002 (hereinafter "the Investment Protection Principles"). In retaining and evaluating any such financial organization, CalSTRS will give significant consideration to whether such organization has adopted the Investment Protection Principles.

The Investment Protection Principles are as follows:

- sever the link between compensation for analysts and investment banking;
- prohibit investment banking input into analyst compensation;
- create a review committee to approve all research recommendations;
- require that upon discontinuation of research coverage of a company, firms will disclose the coverage termination and the rationale for such termination; and
- disclose in research reports whether the firm has received or is entitled to receive any compensation from a covered company over the past 12 months.
- establish a monitoring process to ensure compliance with the principles;

B. CalSTRS will give significant consideration, in retaining and evaluating money managers, as to whether such managers are abiding by the following:

1. Money management firms must disclose periodically any client relationship, including management of corporate 401(k) plans, where the money management firm could invest CalSTRS' moneys in the securities of the client.
2. Money management firms must disclose annually the manner in which their portfolio managers and research analysts are compensated, including but not limited to any compensation resulting from the solicitation or acquisition of new clients or the retention of existing clients.
3. Money management firms shall report quarterly the amount of commissions paid to broker-dealers, and the percentage of commissions paid to broker-dealers that have publicly announced that they have adopted the Investment Protection Principles.

[illegible]

4. Money management firms affiliated with banks, investment banks, insurance companies or other financial services corporations shall adopt safeguards to ensure that client relationships of any affiliate company do not influence investment decisions for the money management firm. Each money management firm shall provide CalSTRS with a copy of the safeguards plan and shall certify annually to CalSTRS that such plan is being fully enforced.
5. In making investment decisions, money management firms must consider the quality and integrity of the subject company's accounting and financial data, including the its 10-K, 10-Q and other public filings and statements, as well as whether the company's outside auditors also provide consulting or other services to the company.
6. In deciding whether to invest CalSTRS moneys in a company, money management firms must consider the corporate governance policies and practices of the subject company.

The principles set forth in paragraphs 5 and 6 are designed to assure that in making investment decisions, the money management firms give specific consideration to the subject information and are not intended to preclude or require investment in any particular company.